To: Interested Parties
From: Dick Barrett[1]
Re: Implications of CI121
Date: February 22, 2022

The purpose of this analysis is to describe, to the extent possible, the likely impacts of CI121, were it to be placed on the ballot and passed by the voters this November. In particular, the analysis focuses on the probable impacts of CI121 on (a) shifting of the property tax base (and accordingly, property tax payments) among property tax payers and classes and (b) the revenue raising capacity of local governments, school districts, and other property tax dependent entities (e.g. fire districts).

Many of the impacts of CI121 are hard to predict because they depend on decisions the legislature either must make or can chose to make to implement the initiative if it is approved. Other impacts can vary substantially from one locality to another, depending on such factors as the rate of housing turnover, rates of reappraisal in both residential and non-residential properties, the mix of non-residential property types, and the existing level of property taxation in the local area. These considerations can become quite complex, and to a significant degree then, when deciding whether or not to support CI121, voters will be flying blind when it comes to how they, and their communities, will be individually affected.

CI121 Provisions

There are two basic provisions in CI121.[2] The first provision is that when the initiative takes effect in 2024, the assessed valuations of residential properties will revert to their 2019 values, and thereafter cannot change from one year to the next by more than 2%, or the percentage increase in the Consumer Price Index, whichever is less.[3] This restriction applies only to existing residential properties that have not changed hands nor been "significantly improved" during the course of the year. Because historically the inflation rate has usually been higher than 2%, and certainly averaged more than 2% annually over the past three decades, it is assumed in what follows that the assessed valuation of these residential properties will increase at 2% per year.[4]

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[2] See https://sosmt.gov/docs/732/elections/46481/ballot-lang-for-constitutional-initiative-121.pdf for the complete language of the initiative. See https://sosmt.gov/docs/732/elections/46506/6-final-fiscal-note-ballot-9.pdf for the Office of Budget and Planning fiscal note.

[3] It is unclear what 2019 values will be assigned to new properties added to the tax rolls between 2020 and 2024.

[4] This assumption applies to each individual property and hence residential property as a whole. There is a slight ambiguity in the language of the initiative when it comes to the relatively rare circumstance in which residential property values fall. The initiative language says that residential property values cannot *change* by more than 2% or the rate of inflation (call it i), whichever is smaller, but it is not clear whether that means values cannot *increase* by more than 2% (or i, if it's smaller) or *change by plus or minus* 2% (or i, if it's smaller). It's not clear whether this

CI121 requires that the assessed valuation of properties that have changed hands, been "significantly improved," or are new, be set at their fair market value in the year in question, and thereafter will increase in value at the same rate as other properties, i.e. by assumption here, 2%.

It is important to note that CI121 explicitly leaves the definition of "residential property" to the legislature. Other terms, e.g. "significantly improved," will have to be defined as well, although that is not stated in the language of the initiative.

The second provision of CI121 is that the legislature must limit the total amount of taxes assessed against a residential property to no more than 1% of its total assessed value.

The Effect of Reverting to 2019 Assessed Values of Residential Properties

In 2024, the reversion to 2019 residential property values will shift the property tax base from residential to non-residential property, but this shift will more than offset the shift in the opposite direction, i.e. from non-residential to residential, that is expected to occur over the five year 2019-2024 period.

The composition of the tax base in 2019 can be represented by the ratio of the taxable value of residential to non-residential property, i.e. T_{R19}/T_{NR19}, where T_{R19} and T_{NR19} are the 2019 taxable values of residential and non-residential property respectively. The higher the value of this ratio, the larger the share of residential property in the tax base; the lower its value, the larger the share of non-residential property in the tax base.

Due to both general inflation and particularly to high housing market inflation, the *assessed valuation* of both types of property is expected to grow substantially between 2019 and 2024. Call the proportions by which the two property types grow G_R and G_{NR}. It's anticipated that G_R will be greater than G_{NR}; that is, the assessed value of residential property will grow more than that of non-residential property. For simplicity, assume that no new property of any kind is added to the tax base and statutory tax rates are left unchanged.[5] That implies that *taxable values* of both property types will grow in the same proportions, and in 2024 the ratio representing the composition of the tax base will equal $T_{R19}(1 + G_R)/T_{NR19}(1 + G_{NR})$. Over the 2019 to 2020 period,

language would imply that in 2008, for example, when residential property values were falling, assessed values for tax purposes could not decline by more than 2%, or i, which was a little less than .5% that year.

[5] The use of the term "tax rate" here conforms with the Montana code but is somewhat confusing. It refers to percentage of the *market value* of a property that is the legislature has determined to be its *taxable value.* Taxes paid on the property are then equal to its taxable value (in thousands of dollars) times the sum of the mills imposed by the various taxing jurisdictions in which the property is located. These "tax rates" are specified in MCA Title 15, Chapter 6, Part 1, where they are also referred to, perhaps more clearly, as "taxable percentages." The term "tax rate," (as is "marginal tax rate," "capital gains tax rate," "tariff rate," etc.), usually refers to the ratio (taxes levied)/(tax base).

the tax base will shift, perhaps substantially, towards residential, and away from non-residential property.

Presumably CI121 rolls assessed residential property values back to their 2019 levels in order to unwind this anticipated shift. But it more than unwinds it. After the roll back, the value of the composition ratio will be $T_{R19}/T_{NR19}(1 + G_{NR})$, and the non-residential share of the tax base would be higher than it was in 2019. How much higher depends on how fast its assessed value grows through 2024, i.e. the value of G_{NR}. This value is unknown and will be unknown at the time voters are asked to approve the measure.

Thus, CI121 fails to reestablish the 2019 relative taxable values of residential and non-residential properties. If reestablishing that known relative value was what the authors CI121 intended, the initiative should return all properties, residential and non-residential, to their 2019 values.

If, over the 2019-2024 period, local taxing entities wish to maintain a constant stream of revenue as allowed by current law,[6] mills will "float down", taxes on residential property will rise and taxes on non-residential property will fall until 2024. But in that year, with the rollback of residential values, taxes on residential property will fall and on non-residential property will rise, in both cases quite substantially; this shift in the tax burden away from residential and towards non-residential property would follow a five year period in which the burden was shifting in the opposite direction, i.e. towards residential. Nevertheless, the whipsawing of tax levels that will occur in 2024 as a result of CI121 appear to be potentially quite disruptive.[7]

Shifts in the Property Tax Base and Payments Among Residential Properties

CI121 can expected to produce substantial shifts of the residential property tax base between residential properties and taxpayers, and these shifts will have significant impacts on the fairness of property taxation, and the incentives created by its operation.

One critical question in this regard is the definition of residential property, which in CI121 is left to the legislature. Should the legislature choose to define residential property as owner occupied homes only, the result would be that rental properties would appreciate significantly more rapidly than owner occupied homes capped at 2%.[8] The residential property tax base would shift away from owner occupied homes and towards rental properties, and (holding total property

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[6] In fact current law will allow local taxing entities to increase revenues over the period, which will exacerbate the increase in residential taxes, and limit the decline in non-residential taxes, which stem from the changing composition of the tax base discussed here.

[7] The magnitude of these abrupt changes in 2024 tax levels obviously depends on how much residential and non-residential property values change, absolutely and in relation to one another between 2019 and 2024, but for example, if G_R and G_{NR} are .20 and .10 (which doesn't seem outlandish), taxes in 2024 on residential and non-residential property will fall and rise respectively by about 10%.

[8] Under current law, apartment buildings with more than 4 units are generally treated as class 4 commercial rather than class 4 residential properties.

revenue constant) tax payments would shift from homeowners to renters (who pay property taxes in their rents).[9] Since the incomes of the former are higher than the latter, this shift would make the property tax even more regressive than it already is, and run counter to the notion that property tax relief should be means tested.

Whether the burden of residential property taxes will be shifted to renters will depend on one decision (among many others) that the legislature would have to make to implement the provisions of CI121. But there are other shifts among residential property taxpayers that would necessarily happen regardless of what the legislature did.

Consider the hypothetical but not unrealistic example of two families in nearly identical financial situations (with respect to income, expenses, number of family members, etc.), both of which buy nearly identical houses worth $400,000 in the same year. Assume that over a ten year period, the fair market value of these houses increases at 6% per year;[10] in 10 years they would be worth $716,339. But under the provisions of CI121, the assessed value of these houses cannot increase by more than 2% per year; after 10 years the assessed value for tax purposes of each house would be $487,597. If then, after 10 years, one of these families moves (to take a new job, for example) into a new house equal in market value to the one it is vacating, the assessed value of its property will rise by 47% (from $487,597 to $716,339). Assuming no change in the mill rate, its taxes will also go up by 47% and although it is otherwise similarly situated to the family that doesn't move, its property taxes will be 47% higher. If total mills on these properties are, for example, 600, taxes on the home changing hands would increase by $1,850, from $3,950 to $5,800.

By equalizing the rate of reappraisal of residential properties (with the exception of those changing ownership or undergoing significant improvement) at 2%, CI121 will reduce the internal shifting of residential property tax base that currently occurs because of differences in the reappraisal rates of individual residential properties, even within the same jurisdiction. These differences can be quite substantial.[11] In effect, CI121 freezes the relative values of most individual properties at their 2019 levels. Accordingly, CI121 provides more assistance to properties which would otherwise appreciate more rapidly after 2019 than to properties that would appreciate more slowly.[12]

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[9] More generally, tax payments would shift to the owners of non-residential property, including any sort of dwelling space (second homes, recreational properties, mobile home lots, etc.) that the legislature excluded from the definition of "residential property."

[10] Notwithstanding the astronomical housing market inflation of the two years, the average annual rate of increase in the national median price of homes was about 6% over the past three decades. See Federal Reserve Bank of St. Louis https://fred.stlouisfed.org/series/MSPUS.

[11] For example, between 2008 and 2017 in Missoula County, the taxable value of the 20% of properties with the highest rates of reappraisal rose by an average of 40%, despite the substantial mitigating reductions in the residential tax rate enacted by the 2009 Legislature. And the taxable value of the 20% of properties with the lowest rates of reappraisal fell by 16%. See https://leg.mt.gov/content/Committees/Interim/2019-2020/Revenue/HJ-35-Background/hj-35-additional/barrett-revenue-caps.pdf

[12] It is difficult to determine whether this pattern of assistance causes tax liabilities to conform more or less closely with ability to pay. But if there is a positive (negative) correlation between rates of reappraisal on properties and

CI121 can also potentially create differences in the tax liabilities of very similar properties with the imposition of the 1% (of assessed value) property tax cap. Consider the example of similar properties, some of which are located within a city such as Missoula, with others just outside of the city, in Missoula County. Total mills imposed on the city properties (by the city, county, schools, etc.) are high enough for their tax liabilities to exceed the 1% cap. As discussed in more detail below, capping the taxes paid on city properties will create a revenue shortfall for all the entities, including the county, imposing mills on properties in the city. There are no provisions in current law for dealing with these shortfalls, so the legislature will have enact them. One possibility in this regard would be to allow the county to impose more mills; county taxes would rise on all county properties (including residential) but not on city residential properties (because they are capped). The total county tax liability would shift out of the city, identically valued houses within and outside the city would pay different county taxes, and city residents could vote for county levies without increasing their own tax liabilities.[13]

Clearly these results are inconsistent with the letter and intent of Article VIII, Section 3 of the Montana Constitution, which requires the state to "appraise, assess and equalize the valuation of all property.." Accordingly, CI121 has to be and is being offered as an amendment to this constitutional equalization provision.

Although it is not expressly required to do so by the initiative, it is clear that the Legislature will have to define the "significant improvement" that can trigger a reset of the assessed value of a residential property to its actual current market value. This definition could be quite consequential. Take, for example, the calculation of the the tax consequences of adding a $100,000 improvement to a residential property. At the current statutory residential property tax rate of 1.35%, if such an improvement adds $100,000 to the market value of the property, its taxable value will rise by $1,350 and, at 600 mills, taxes on the property will rise by $810. But suppose now that the property in question is one of the hypothetical (but realistic) ones described above, which, under CI121, has an assessed value of $487,597 and a true market value of $716,339. The contemplated improvement will raise the market value to $816,339, and if it is considered "significant," the assessed value of the property will increase by $328,742 (from $487,597 to $9816,339), its taxable value will rise by $4,438, and its taxes by $2,662. CI121 thus significantly increases the tax cost of improvements.

Although the intent of CI121 is apparently to provide tax relief to residential property in the aggregate, it is clear that it also rewards older, long-time residents of a community at the expense of their younger, newer neighbors; disincentivizes moves that might otherwise improve household incomes; discourages property improvements, and (depending on implementing legislation) can shift the burden of residential property taxes from higher income home owners

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their assessed valuations, this pattern of assistance would increase (reduce) the regressivity of residential property taxes.

[13] More generally, under the initiative owners of residential properties subject to the cap can support voted levies which will raise additional revenue but not their own taxes.

to lower income renters, and from urban properties to rural ones. Whether these consequences are intended or not is unclear, but what is clear is that discouraging mobility and property improvements, and increasing tax regressivity, are highly undesirable outcomes. Proponents of CI121 argue that by rewarding residential longevity, the initiative will "stabilize" neighborhoods. That may indeed be the case - in California, turnover of homes fell significantly following enactment of a similar measure – but it is not clear that neighborhoods across Montana currently display inadequate stability, whatever that may be. It is also not clear that a shift of the tax burden from long time residents to newcomers is consistent with any other accepted standard for tax shifting, such as conforming tax burdens more closely with ability to pay.

Shifts in the Property Tax Base and Payments Among Property Tax Classes

The stated intent of CI121 is to limit the growth of residential property tax liabilities, but unless the growth of all property tax payments is limited to the same degree, residential property tax growth can only be slowed by shifting the tax base from residential to non-residential property.[14] The 2024 rollback of residential assessed valuations to their 2019 levels will have that effect, and it is quite likely that such shifting will continue after that year.

We can again represent the residential/non-residential composition of the tax base with the ratio T_R/T_{NR}, and we want to know how this ratio will change over time as a result of CI121. Letting g_{TR} and g_{TNR} be the rates of growth in T_R and T_{NR}, and $c_{R/NR}$ be the rate of change in T_R/T_{NR}, then

(1) $c_{R/NR} = g_{TR} - g_{TNR}$

Equation (1) expresses formally what should be intuitively pretty obvious: if the taxable value of existing non-residential property grows more rapidly than the taxable value of existing residential property ($g_{TNR} > g_{TR}$), the non-residential share of the tax base will rise and the residential share will fall. This is the anticipated effect of CI121.[15]

Changes in the taxable value of property are driven by changes is assessed value and legislatively determined changes in tax rates. Under CI121, assessed values for non-residential property and residential property which changes ownership (or is significantly improved) are market determined. Assessed values for all other residential property grow at 2% per year. Equation (2) shows the rate of change in the tax base composition ratio (T_R/T_{NR}) as a function of these factors.

(2) $c_{R/NR} = [w_R + .02s_{NC} + (1 - s_{NC})g_{MRS}] - [w_{NR} + g_{MNR}]$

[14] The focus here is on changes in the composition of the *existing* tax base due to differences in the rates of appreciation of its component tax classes. Such changes will redistribute the taxes paid by each class of existing property, even if overall tax payments are unchanged.

[15] Conversely, if the taxable value of residential property is increasing more rapidly than the value of non-residential property, which is likely to be occurring presently, the residential share of the tax base will increase.

where w_R and w_{NR} are the legislatively determined rates of change, if any, in residential and non-residential tax rates, s_{NC} is the share of residential property not subject to market value assessment (assessment grows at 2% per year), and g_{MRS} and g_{MNR} are the market determined rates of change in the assessed value of (a) residential property changing owners and (b) non-residential property, respectively.[16]

Assume, for the moment, that the legislature leaves tax rates unchanged. In that case, $w_R = w_{NR} = 0$, and equation (2) simplifies to

(3) $c_{R/NR} = [.02s_{NC} + (1 – s_{NC})g_{MRS}] – [g_{MNR}]$

Will $c_{R/NR}$ be negative, i.e., will the property tax base shift away from residential to non-residential property? The presumptive effect of CI121is that it will, given that non-residential property is likely to appreciate at well more that 2%, especially in the current high inflation environment. But it is possible that in tax jurisdictions in which (a) non-residential property appreciates slowly (the value of g_{MNR} is relatively low for whatever reason, e.g. nonresidential property is primarily agricultural), and/or (b) a relatively small share of residential property doesn't change hands (s_{NC} is relatively low), and/or (c) the rate of appreciation of property changing hands (g_{MRS}) is relatively high, little or no shift of the property tax base towards non-residential property would occur. Indeed, the shift could be in the other direction.

On the other hand, it is clear that the effect of CI121 is unambiguously to reduce the rate at which the tax base would otherwise shift towards residential property, regardless of whether that rate is positive or negative.[17] Other things equal, the rate of growth of taxes on residential property will thus be reduced by CI121, and the rate of growth of taxes on non-residential property accelerated.

All these effects depend on the assumption that the legislature does not change the tax rates for various property classes. If it does change tax rates, i.e. if the values of w_R and w_{NR} in equation (2) are not equal to 0, all bets are off. The legislature could neutralize any shift of the tax base towards nonresidential property by raising the tax rate on residential property (w_R) and/or lowering the tax rate on non-residential property (w_{NR}).[18] Such neutralization would hardly be novel; the legislature in the past has routinely adjusted tax rates to prevent substantial changes in the composition of the tax base by tax classification. Notably, in 2009, after a 6 year reappraisal cycle that increased the average *assessed valu*e of residential property statewide by a little more than 50%, the legislature adjusted the residential property tax rate to prevent any increase in the statewide aggregate *taxable value* of residential property.[19]

[16] The derivation of equation (2) is provided in the end note.
[17] This results from the reasonable expectation that the rate of growth in the market value of residential properties changing hands, g_{MRS}, will always be greater that 2%, so limiting the growth in the taxable value of any part of the residential tax base to 2% reduces the rate of growth of in the taxable value of the residential tax base as a whole.
[18] This is true as well of the shifts in the tax base that will occur in 2024 when residential assessed values are rolled back to their 2019 levels, described above.
[19] Both the increase in assessed value and offsetting reduction of the tax rate were phased in over 6 years.

It is worth noting, however, that the changes in the residential tax rate coming out of the property tax reappraisal mitigation measure adopted by the 2009 legislature prevented a shift of the tax base to residential property on average, across the state. There were still counties (e.g. Flathead and Gallatin) where residential property values had grown by much more that the statewide average; in these counties, even after mitigation, the tax base and tax payments shifted towards residential property. In other counties, of course, the reverse was true.

It is interesting, then, that although the clear intention of CI121 is to reduce residential property taxes (or at least their growth) by shifting the property tax base and payments away from residential property and towards nonresidential property, there is nothing in the initiative to prevent the legislature from neutralizing those shifts with the appropriate adjustment of tax rates,[20] and in the past the legislature has done just that. But such neutralization would work on a state wide basis; following it, there would still be taxing jurisdictions in which the tax base shifted *towards* residential property (albeit less so than in the absence of neutralization) and others in which the shift would be *away* from residential property. [21]

Impact on Local Property Tax Revenue

Under current law (notably as contained in MCA 15-10-420 and various school funding provisions), local governments and school (and other) districts are given revenue authority, i.e. allowed to raise specified amounts of revenue (Rv). Given these revenue authorities and the total taxable value of property in the jurisdiction, T,[22] each taxing entity determines the mill rate, m, it will impose[23], i.e.

(4) $m = Rv/T$

Under CI121, taxes paid on a residential property (Rv_R) cannot exceed 1% of the property's assessed value. This implies, in turn, that taxes on the property cannot exceed the amount that would be owed if the total of the mills levied on the property by the various taxing entities equaled $.01/t_R$, where t_R is the residential property tax rate defined above.[24] The current value

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[20] Nothing, that is, except political survival. Presumably the legislature would not want to deliberately undo what the public attempted to accomplish by voting in favor of CI121.

[21] Similarly, even if a tax rate adjustment leaves the taxable value of residential properties as a whole unchanged the taxable values of individual residential properties will continue to rise or fall as their reappraisal rates exceed or fall short of the average increase for residential property as a whole.

[22] From above, $T = T_R + T_{NR}$

[23] The term m expresses millage in decimal terms. e.g. for 500 mills, m = .5

[24] Under CI121, $Rv_R <= .01M_R$. Since $Rv_R = mT_R$ and $T_R = t_RM_R$, $Rv_R = mt_RM_R$. So $mt_RM_R <= .01M_R$ and $mt_R <=.01$, or $m <= .01/t_R$

of t_R is 1.35% (.0135), which means that under CI121 the maximum taxes that could be levied on a residential property would be the taxes levied with 741 mills (m = .741).[25]

As long as the total of mills imposed by the various taxing entities (cities, counties, schools, fire districts, etc.) does not exceed 741, CI121 will not prevent those entities from setting mill rates and collecting as much revenue as currently allowed under the law.

But what will happen if the total mills imposed by the taxing entities exceeds 741, and equals 800, for example?[26] Consider the situation of the owners of a property with a market value of $400,000 and a taxable value of $5,400. At 800 mills, the taxes on such a property would be $4,320 (=.8 x 5400). But under CI121, the owners would pay no more than $4,000 (=.01 x 400,000). The difference, $320, would be revenue lost to the taxing entities. How that loss would be distributed among the taxing entities would be a matter the legislature would have to decide. For example, it might decide to prorate the revenue loss among the taxing entities in proportion to their share in the 800 mills.

This calculation demonstrates that in the absence of a legislative fix, CI121 would prevent some groups of taxing entities (those with combined mills greater that 741) from raising the full amount of revenue currently allowed by law.[27] But there are a variety of fixes that the legislature could enact to restore local government and school revenue authority.

One simple solution would be for the state to absorb all or a disproportionate share of the $320 shortfall described above. From a residential property with a taxable value of $5,400, the 102 mills imposed by the state would normally raise $551 in revenue. If the state absorbed the $320 shortfall, that revenue would decline to $231. The revenue authority of local taxing entities would be unimpaired, but the state would experience a decline is revenue that would have to be replaced, presumably by other General Fund sources.

Another possibility would be to require the property owners to pay the full $4,320 due at 800 mills, but then allow them to claim a fully refundable $320 income tax credit. This mechanism would operate much like the circuit breakers that have been proposed (but not approved) in recent legislative sessions.[28]

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[25] Since the tax rate on the portion (if any) of assessed value of a residential property in excess of $1.5 million is 1.89, such properties could not have a tax liability greater than that resulting from the imposition of something between 538 mills and 741 mills.

[26] Some observers (notably the Office of Budget and Planning in its fiscal note, cited above in fn. 2) have suggested that CI121 caps total mills at 741, and that that cap would necessarily apply to all property, residential or otherwise. That is not in the initiative language and it would be nightmarishly complicated to set the various mill rates of the several taxing entities at levels such that they totaled 741, particularly since some properties in a jurisdiction would be at the cap and others would not. In any case, it is assumed here that what is capped in CI121 is the tax liability of residential properties, but not the total mills levied.

[27] Note that many local governments already contend that the revenue they are allowed to raise is inadequate.

[28] With a very significant difference. Here, the amount of tax relief would be proportional to the assessed value of the property. Under a circuit breaker, property tax relief is provided progressively, i.e. inversely in relation to income.

In both these cases, what is essentially happening is that residential property tax relief is being provided, paid for by the state. As noted previously, there appears to be no compelling rationale for how that relief is provided – who gets it and how much - but it probably doesn't matter. In recent sessions the legislature has consistently refused to provide local governments with the means to raise additional revenue and/or provide significant general property tax relief. CI121 provides property tax relief by reducing local government and school system revenues, and given the legislature's current disposition, it is likely to stay that way.

Another option would be to change the way local taxing entities compute mills, given their revenue authority. Suppose a local entity has the authority to raise total revenue of Rv*. This revenue will come from the taxes on residential property, which under the terms of CI121 will equal 1% of the assessed value of the residential property subject to the cap (call it M_{R*}), and the taxes paid on all property (residential and non-residential) not subject to the cap, equal to the mill rate times the taxable value of uncapped property, i.e. mT_{NR*}. The local taxing entity could then generate Rv* with a mill rate, m*, given by[29]

(5) $m^* = (Rv^* - .01M_{R*})/T_{NR*}$

In essence what would be happening in this case is that residential tax relief would be provided, paid for by imposing higher mills on nonresidential and uncapped residential property.[30] This transfer from capped residential to all other (mainly non-residential) property would be in addition to the transfers occasioned by the redistribution of the property tax base created by CI121, described above.

Summary

If enacted, CI121 would have the following effects: (1) A substantial redistribution of the residential tax base among residential properties. This redistribution would not, in general, be consistent with differences is ability to pay (and would be inequitable as a result), and depending on legislative action, could be highly regressive. (2) The creation of significant disincentives to mobility and to the improvement of residential properties. (3) In many cases, a shift of the tax base and tax burden from residential to non-residential property, and in all cases, an acceleration of that shift where it is occurring and a deceleration in the shift towards residential property, where that is occurring. (4) In some cases, a reduction in the amount of revenue local taxing

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[29] Setting m* would be difficult in practice because the amount of residential property subject to the cap and its value (M_{R*} in equation 5) are not independent of the sum of m* itself and the mills being imposed by other taxing entities.

[30] A simpler way of achieving almost the same result would be to substantially reduce the residential property tax rate. At a tax rate of 1%, for example, up to 1000 mills could be imposed on residential property without exceeding the 1% of assessed value cap. That, of course, would result in a large shift of the tax base and tax liabilities from residential to non-residential properties, but that is inevitable if the goal is to reduce residential property taxes and maintain local government revenues at no cost to the state.

entities could raise under current law. It is doubtful that voters will be aware of all these effects when and if they are called upon to vote on the measure, and it is certain that they will not know their magnitude. As described above, there are multiple actions the legislature could take to reverse many of these effects, although the likelihood of its doing so at this point seems slight.

Note: Derivation of Equation (2)

The rate of change in T_R/T_{NR} is given by

(1') $C_{R/NR} = g_{TR} - g_{TNR}$

The taxable value of residential property is equal to its assessed value (M_R) times the residential property tax rate established by the legislature (t_R), i.e.

(2') $T_R = t_R M_R$,

and analogously,

(3')$T_{NR} = t_{NR} M_{NR}$.

The rate of growth of the residential property tax base, g_{TR} is then given by

(4') $g_{TR} = w_R + g_{MR}$,

where w_R is the rate of change (if any) in the residential property tax rate (again, established by the legislature) and g_{MR} is the rate of growth of the assessed value of residential property. Analogously,

(5') $g_{TNR} = w_{NR} + g_{MNR}$.

Under CI121, the rate of growth of assessed value in residential property, g_{MR}, will be a weighted average of the rate of growth in the value of properties that have not changed hands (2%) and the market determined rate of growth in properties that have changed hands or been "significantly improved" (g_{MRS}), i.e.

(6') $g_{MR} = .02s_{NC} + (1 – s_{NC})g_{MRS}$

where s_{NC} is the share of all residential property that does change hands and hence appreciates in assessed value at 2% per year. Substituting from equations (2') – (6') into (1'),

(7') $c_{R/NR} = [w_R + .02s_{NC} + (1 – s_{NC})g_{MRS}] – [w_{NR} + g_{MNR}]$

Assume, for the moment, that the legislature leaves tax rates unchanged. In that case, $w_R = w_{NR} = 0$, and equation (7’) simplifies to

(8’) $c_{R/NR} = [.02s_{NC} + (1 – s_{NC})g_{MRS}] – [g_{MNR}]$